Supreme Court, U.S.
FILED
98 630 OCT 9 1998
OFFICE OF THE CLERK

No.

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1998

ERIK J. HAMILTON,

Petitioner,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

PETITION FOR A WRIT OF CERTIORARI

DAVID M. DUREE
Counsel of Record
REINERT & DUREE, P.C.
812 North Collins
St. Louis, MO 63102
(314) 621-5743
Attorneys for Petitioner

3918

QUESTIONS PRESENTED

I. Whether the Federal Arbitration Act preempts general state contract law principles, applicable to all contracts, when an arbitration clause is included.

II. Whether the Federal Arbitration Act authorizes United States district courts to compel arbitration of damage claims pending in previously filed, non-removable, state cases.

LIST OF PARTIES

The names of all parties to the proceedings in the Court whose judgment is sought to be reviewed here appear in the caption of the case. There are no parent or subsidiary companies of any party to be listed.

TABLE OF CONTENTS

Page

Questions Presented i

List of Parties ii

Table of Contents iii

Table of Citations v

Opinion Below 1

Statement of Jurisdiction 2

Statutes Involved 2

Statement of the Case 3

Reasons for Granting the Writ 6

I. The Petition should be granted because the decision below conflicts with prior opinions of this Court holding that only state laws referable specifically to arbitration contracts are preempted by the Federal Arbitration Act 6

II. The Petition should be granted because the enforcement sections of the Federal Arbitration Act (9 U.S.C. §§ 3, 4) do not provide statutory authority to United States district courts to compel arbitration of damage claims pending in previously filed, non-removable, state cases 10

Conclusion 15

Appendix 1a

Judgment and opinion of the United States Court of Appeals for the Second Circuit, July 14, 1998 ..... 1a

TABLE OF CITATIONS

CASES CITED

Page

Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. 265 (1995) 7, 8

Doctor's Associates, Inc. v. Casarotto, 116 S. Ct. 1562 (1996) 7, 8

Doctor's Associates, Inc. v. Distajo, et al., 66 F.3d 438 (2nd Cir. 1995) 14

Doctor's Associates, Inc. v. Stuart, 85 F.3d 975 (2nd Cir. 1996) 14

First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 115 S. Ct. 1920 (1995) 7, 8

Instructional Systems, Inc. v. Computer Curriculum Corp., 130 N.J. 323, 614 A.2d 124 (1992) 3, 9

Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 146 N.J. 176, 68 A.2d 618 (1996) 4, 9

M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972) 9

Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) 7, 11, 13, 14

Perry v. Thomas, 482 U.S. 483 (1987) 7, 8

Southland Corp. v. Keating, 465 U.S. 1 (1984) 7, 8, 9

Volt Informational Sciences, Inc. v. Leland Stanford, Jr. University, 489 U.S. 468 (1989) 7, 10

Whiteside v. Teltech Corp., 940 F.2d 99 (4th Cir. 1991) 12

STATUTES CITED

46 A.B.A. Rep. 359 13

47 A.B.A. Rep. 315 13

49 A.B.A. Rep. 284 13

9 U.S.C. § 1, et seq. 3, 7, 12, 13

9 U.S.C. § 3 ..... 2, 7, 10, 11, 12, 13

9 U.S.C. § 4 ..... 2, 4, 6, 7, 10, 11, 12, 13

28 U.S.C. § 1254(1) 2

28 U.S.C. § 2283 11

N.J.S.A. 56:10-1 through 56:10-15 ..... 3, 9

Supreme Court Rule 10(c) 6, 10

No.

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1998

ERIK J. HAMILTON,

Petitioner,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI

Petitioner, Erik Hamilton, respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINION BELOW

The opinion below is reported at 150 F.3d 157 (2nd Cir. 1998) and reproduced in the Appendix at pages 1a-15a.

STATEMENT OF JURISDICTION

The Court of Appeals entered judgment on July 14, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

9 U.S.C. § 3.

§ 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 4.

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written

agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. * * *

STATEMENT OF THE CASE

Erik Hamilton (the franchisee) is a New Jersey citizen who operated a Subway Sandwich franchise shop in New Jersey pursuant to a franchise agreement with Doctor's Associates, Inc. (hereinafter "DAI"), a Florida corporation with its principal office and place of business in Milford, Connecticut.

The Subway Sandwich franchise shop was operated in New Jersey and therefore ostensibly governed by the New Jersey Franchise Act, N.J.S.A. 56:10-1 through 56:10-15.

The New Jersey Supreme Court has previously held that choice of law clauses, applying the law of states other than New Jersey to franchise agreements operated by New Jersey citizens within the State of New Jersey, are void and unenforceable as against the public policy of New Jersey. Instructional Systems, Inc. v. Computer Curriculum Corp., 130 N.J. 323, 614 A.2d 124 (1992). The New Jersey Supreme Court has also previously ruled that choice of forum clauses in New Jersey franchise agreements operated by New Jersey citizens within the State of New Jersey, requiring litigation in states other than New Jersey, are void and unenforceable as against the

public policy of New Jersey. Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 146 N.J. 176, 68 A.2d 618 (1996).

The Subway Sandwich franchise agreement at issue contained a choice of law clause applying the law of Florida and a choice of forum clause requiring arbitration in Bridgeport, Connecticut.

When a dispute arose about Erik Hamilton's claim that he was fraudulently induced into the franchise agreement by false representations about the past business success of the existing Subway shop he acquired, DAI filed an arbitration demand with the American Arbitration Association in Hartford, Connecticut on December 26, 1996.

On January 22, 1997, Erik Hamilton and Hamilton Williams, Inc. (the corporation through which he operated the Subway franchise) filed suit against DAI and its development agents, William McClain and Michael Stocklin in Middlesex County, New Jersey, alleging common law fraud and violation of the New Jersey Franchise Act. Michael Stocklin shared New Jersey citizenship with Erik Hamilton.

On March 14, 1997, DAI filed a petition to compel arbitration against Erik Hamilton in the United States District Court for Connecticut pursuant to 9 U.S.C. § 4, along with a petition to enjoin Erik Hamilton from prosecution of the New Jersey action against DAI, William McClain and Michael Stocklin.

The franchise agreement also provides that the parties are required to litigate in Connecticut and

waive their right to a trial by jury, if the arbitration clause is unenforceable. The franchise agreement limits damage claims by franchisees to no more than $50,000.00 and excludes claims for punitive or consequential damages, while permitting DAI to prosecute claims for infringement of its trade marks or copyrights or for disclosure of confidential information in excess of $50,000.00. The franchise agreement further imposes a penalty upon the franchisee, for all expenses and attorney's fees incurred by DAI, for any violation of the damage limitation clause.

The franchise agreement was not negotiable. Erik Hamilton was required to sign it as is, or not become a Subway franchisee. Erik Hamilton lost his entire net worth through the operation of the franchise agreement. His only asset is a car valued at $2,000.00, and he still owes the bank $55,000.00 for the loan used to fund the franchise operation.

DAI offered Erik Hamilton $50,000.00 (the amount of the damage limitation clause) to settle his claim before he filed suit in New Jersey. When he declined the $50,000.00 offer, an in-house attorney advised him that DAI would force him into arbitration and keep him tied up in court and/or arbitration for five years. He negotiated with DAI for 11 months before filing his lawsuit. He has insufficient funds to pay as much as $1,000.00 to the American Arbitration Association. Excluding attorney's fees, the costs to Erik Hamilton of arbitrating in Connecticut before the American Arbitration Association is estimated to be $20,000.00 for American Arbitration Association fees, transcripts and the fees of the arbitrators and an

additional $8,000.00 to $12,000.00 for travel and lodging for him, his attorney and witnesses.

The District Court held that diversity jurisdiction exists because DAI did not enforce the $50,000.00 damage limitation clause, that it was not necessary to determine whether New Jersey law applied and that New Jersey law was preempted by the Federal Arbitration Act.

The court below affirmed on July 14, 1998, holding that New Jersey law was preempted by the Federal Arbitration Act, Appendix, p. 10a, and that 9 U.S.C. § 4 permits a United States district court to compel arbitration of damage claims previously pending in a non-removable state case, Appendix, p. 8a.

REASONS FOR GRANTING THE WRIT

I. The Petition should be granted because the decision below conflicts with prior opinions of this Court holding that only state laws referable specifically to arbitration contracts are preempted by the Federal Arbitration Act.

Petitioner respectfully submits that the opinion below conflicts with relevant decisions of this Court, and alternatively, decides an important question of federal law that has not been, but should be, settled by this Court. The petition should be granted under Supreme Court Rule 10(c).

Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) was decided when the question of whether the Federal Arbitration Act, 9 U.S.C. § 1, et seq. (the "FAA") was a federal procedural statute or substantive law was still undecided. One year later, the Court decided Southland Corp. v. Keating, 465 U.S. 1, 21-36 (1984) holding that the FAA is substantive law which applies in both state and federal courts.

Subsequent cases hold that the validity and enforceability of arbitration clauses are determined by general state contract law principles, within the parameters of the federal policy restrictions of the FAA, so long as the state laws apply to contracts generally and were not developed specifically for arbitration contracts. Perry v. Thomas, 482 U.S. 483, 492, n. 9 (1987); Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. 265, 281 (1995); First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 115 S. Ct. 1920, 1924 (1995) and Doctor's Associates, Inc. v. Casarotto, 116 S. Ct. 1562, 1565 (1996).

In Volt Informational Sciences, Inc. v. Leland Stanford, Jr. University, 489 U.S. 468, 474, 477, n. 6, 478 (1989), the court held that the substantive provisions of the FAA (Sections 1 and 2) apply in both state and federal courts, but the procedural provisions (Sections 3 and 4) do not and that the FAA was merely designed to place arbitration agreements "upon the same footing as other contracts." Justices Stevens, Scalia, O'Connor and Thomas dissented in one or more of these cases, while Justice Rehnquist authored Volt Informational Sciences, Inc. v. Board of Trustees of Leland Stanford, Jr. University, 489 U.S.

468 (1989), which used a choice of law clause in the principal contract to apply California procedure to a dispute about enforcing an arbitration clause, concluding that the California statute, which permitted the trial court to stay arbitration pending litigation of non-arbitrable claims, was not preempted by the FAA.

In Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. 265, 115 S. Ct. 834, 844-45 (1995), Justice Scalia again dissented, stating that he would not dissent in future cases, but stood ready to join four other justices in overruling Southland v. Keating.

Petitioner does not ask this Court to overrule Southland v. Keating. Petitioner does request the Court to limit, however, Southland v. Keating, Perry v. Thomas, Allied-Bruce Terminix Companies, Inc. v. Dobson, Doctor's Associates, Inc. v. Casarotto and First Options of Chicago, Inc. v. Kaplan to their implicit holdings that the FAA does not preempt general state contract law principles applicable to all contracts. Only state laws referable specifically to arbitration contracts are preempted, if inconsistent, by the FAA.

New Jersey has established, by both statute and judicial decision, a strong state policy of protecting New Jersey citizens-franchisees operating franchise shops within New Jersey from the generally more dominant franchisors. The New Jersey Supreme Court has declared choice of law and choice of forum clauses in New Jersey franchise agreements, requiring litigation in other states under the laws of other states, void and unenforceable as against public

policy, as permitted by M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972), which was based upon federal question, admiralty, jurisdiction and involved an international contract. Instructional Systems, Inc. v. Computer Curriculum Corp., 130 N.J. 323, 614 A.2d 124 (1992) and Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 146 N.J. 176, 68 A.2d 618, 623-24 (1996). The New Jersey Franchise Act, N.J.S.A. 56:10-1 through 56:10-15, and New Jersey public policy under the Act apply to all franchise agreements for New Jersey citizens which are operated within New Jersey, not just franchise agreements which contain arbitration clauses. The decision below provides that New Jersey law, applicable to all franchise contracts, not just franchise contracts with arbitration clauses, is preempted by the Federal Arbitration Act and Southland v. Keating. See the Appendix, p. 10a.

Petitioner respectfully submits that the FAA was not intended to preempt general state contract law principles, applicable to all contracts, not just contracts containing arbitration clauses, and that the decisions of this Court do not so provide.

The opinion below precludes the states from adopting state laws to protect their citizens from oppressive agreements even when such state laws apply to all contracts generally, and not just to arbitration contracts. Petitioner respectfully submits that the FAA was not intended to override general state substantive law principles in this fashion.

A state law which precludes choice of law and forum selection clauses for resolution of claims under

the New Jersey Franchise Act, which applies uniformly to both out-of-state litigation and arbitration proceedings, does not conflict with the principles of the Federal Arbitration Act, which merely require that arbitration contracts be placed upon "the same footing as other contracts." Volt Informational Sciences, Inc. v. Leland Stanford, Jr. University, 489 U.S. 468, 474 (1989).

II. The Petition should be granted because the enforcement sections of the Federal Arbitration Act (9 U.S.C. §§ 3, 4) do not provide statutory authority to United States district courts to compel arbitration of damage claims pending in previously filed, non-removable, state cases.

Petitioner respectfully submits that the Second Circuit opinion decided an important question of federal law that has not been, but should be, settled by this Court. The Petition should be granted under Supreme Court Rule 10(c).

The non-removable New Jersey state action by Erik Hamilton against DAI, William McClain and Michael Stocklin was pending when DAI filed its federal petition to compel arbitration in the United States District Court for Connecticut, under 9 U.S.C. § 4, seeking to compel arbitration of the damage claims pending between Hamilton and DAI in the New Jersey state case and an injunction barring further prosecution of the state case against any of the state defendants.

A motion to stay litigation pending arbitration under 9 U.S.C. § 3 may be filed only in the case to be stayed. Even if diversity jurisdiction of DAI's Connecticut federal petition to compel arbitration exists, the Connecticut federal court did not have authority under 9 U.S.C. § 3 to stay the pending New Jersey state action. Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 25, n. 32 (1983), provides "Section 3 likewise limits the federal courts to the extent that a federal court cannot stay a suit pending before it unless there is such a suit in existence."

DAI has used 9 U.S.C. § 4 to accomplish something prohibited by 9 U.S.C. § 3 – the use of one court to stay damage claims pending in another court. After compelling arbitration of the claims between Erik Hamilton and DAI, the Connecticut Federal Court enjoined the entire New Jersey state action. This Court previously held that the decision to stay litigation among the nonarbitrating parties pending the outcome of the arbitration should be left to the federal district court, or the state trial court under applicable state procedural rules, as a matter of the respective courts' discretion to control their dockets. Moses H. Cone, 460 U.S. 1, 20, n. 23 (1983). This Court also previously declined to determine whether the Anti-Injunction Act, 28 U.S.C. § 2283 barred a federal court from staying (or enjoining) a state court suit pending arbitration. Moses H. Cone, 460 U.S. 1, 25, n. 32 (1983). The decision below affirmed the Connecticut Federal Court injunction barring the New Jersey state court from proceeding with litigation between the nonarbitrating parties, using

Section 4, and the injunction, to accomplish what is prohibited by Section 3.

Petitioner respectfully submits that Sections 3 and 4 of the FAA must be read together and that Section 4 does not permit a federal district court to compel arbitration of damage claims previously pending in a non-removable state action, even if diversity jurisdiction exists for the federal petition to compel arbitration. See, however, Whiteside v. Teltech Corp., 940 F.2d 99 (4th Cir. 1991) which held that a federal district court was obligated to determine the arbitrability of damage claims in a pending state action, although the court did not consider the argument advanced here.

9 U.S.C. § 4 permits a party to petition any United States district court which, save for the arbitration agreement * * * "would have jurisdiction under Title 28, in a civil action * * * of the subject matter of a suit arising out of the controversy of the parties * * *." Unless Section 4 is describing a hypothetical action by Erik Hamilton against only DAI, instead of the actual pending state suit by Erik Hamilton against DAI, McClain and Stocklin, the Section 4 requirements of federal jurisdiction of the underlying dispute have not been met here. It makes little sense to base the statutory authority of Section 4 upon a hypothetical lawsuit instead of the real, pending state action. The "would have jurisdiction under Title 28" language in 9 U.S.C. § 4 was intended to apply when the suit claiming damages had not yet been filed. Once the damage lawsuit is filed, motions to enforce the arbitration agreement should be filed there, if possible.

At the time the Connecticut federal action was filed, the Connecticut Federal District Court would not have had jurisdiction under Title 28, but for the arbitration clause, of the subject matter of a suit arising out of the controversy between Erik Hamilton and DAI, because that suit was already pending in the non-removable New Jersey state action. DAI could have determined the validity and enforceability of the arbitration clause in the New Jersey state action under the New Jersey Uniform Arbitration Act.

Section 4 of the FAA does not permit what Section 3 prohibits. "Section 4 provides for an order compelling arbitration only when the federal district court would have jurisdiction over a suit on the underlying dispute." Moses H. Cone, 460 U.S. 1, 25, n. 32 (1983). Here the suit on the underlying dispute was already pending in a non-removable state case when the federal petition was filed. The FAA was not intended to permit one court to compel arbitration of damage claims pending in another court.

This plain meaning interpretative approach is wholly consistent with legislative intent. Congress clearly intended that federal jurisdiction not be affected by the Federal Arbitration Act. Both the first (1921) and the second (1922) drafts of the Federal Arbitration Act contained a section enlarging diversity jurisdiction. 46 A.B.A. Rep. 359; 47 A.B.A. Rep. 315. This section was deleted by the Senate Judiciary Committee before the legislation was enacted. 49 A.B.A. Rep. 284 (1924). Specifically, Senator Walsh, Committee Chairman, stated that the reason for deleting that section was "the reluctance on

the part of Congress to increase the jurisdiction of the federal court." Id.

The Second Circuit, however, has equated diversity jurisdiction of the petition to compel arbitration (not jurisdiction of the underlying dispute) with statutory authority to compel arbitration of damage claims pending in another court. Doctor's Associates, Inc. v. Distajo, et al., 66 F.3d 438, 444-446 (2nd Cir. 1995). The opinion below relies upon Doctor's Associates, Inc. v. Distajo, concluding that diversity jurisdiction of the federal petition to compel arbitration equates with statutory authority (which requires jurisdiction of the underlying dispute) to compel arbitration of damage claims pending in another court. New Jersey law, applicable to all franchise contracts, not just arbitration agreements, however, voids the choice of law and forum selection clauses which DAI relies upon to claim that "save for" the arbitration clause, the Connecticut Federal Court would have had jurisdiction and venue of the underlying dispute. Doctor's Associates, Inc. v. Stuart, 85 F.3d 975, 978, 983 (2nd Cir. 1996).

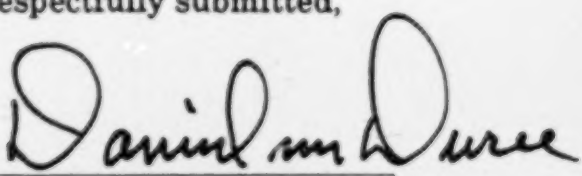
Congress intended that the substantive parts of the FAA (Sections 1 and 2) be enforced by the state courts when they have jurisdiction of the underlying damage claims. Moses H. Cone, 460 U.S. 1, 25, n. 32 (1983), "nevertheless, although enforcement of the Act is left in large part to the state courts, it nevertheless represents federal policy to be vindicated by the federal courts where otherwise appropriate." Under the decision below, the state courts will rarely have the opportunity to apply the FAA to underlying damage claims exclusively within their jurisdiction.

Instead, the parties seeking arbitration will tend to file separate, original, federal actions to determine the arbitrability of pending state damage claims, requiring the federal courts to determine issues governed largely by state law.

CONCLUSION

For the reasons stated, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,



DAVID M. DUREE
Counsel of Record
REINERT & DUREE, P.C.
812 North Collins
St. Louis, MO 63102
(314) 621-5743

Attorneys for Petitioner

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

August Term, 1997

(Argued May 21, 1998 Decided July 14, 1998)

Docket No. 97-9271

DOCTOR'S ASSOCIATES, INC.,

Plaintiff-Appellee,

—v.—

ERIK J. HAMILTON,

Defendant-Appellant.

Before:

MESKILL and KEARSE, *Circuit Judges,*
and TELESCA, *District Judge.**

Appeal from an order of the United States District Court for the District of Connecticut, Dorsey, *J.*, compelling arbi-

---

* Honorable Michael A. Telesca, United States District Judge for the Western District of New York, sitting by designation.

tration and enjoining defendant-appellant Hamilton from prosecuting action in state court.

Affirmed.

DAVID M. DUREE, Reinert & Duree, St. Louis, MO (Nicholas Wocl, Tooher, Puzzuoli & Wocl, Stamford, CT, of counsel), *for Appellant.*

EDWARD WOOD DUNHAM, Wiggin & Dana, New Haven, CT, *for Appellee.*

MESKILL, *Circuit Judge*:

Defendant-appellant Erik J. Hamilton (Hamilton) appeals from an order of the United States District Court for the District of Connecticut, Dorsey, *J.*, compelling arbitration with, and enjoining him from prosecuting a New Jersey lawsuit he filed against, plaintiff-appellee Doctor's Associates, Inc. (DAI), the franchisor of "Subway" sandwich shops. Hamilton challenges the district court's exercise of jurisdiction over this action and the court's failure to apply New Jersey law to resolve Hamilton's challenge to the franchise agreement's arbitral forum selection clause and his unconscionability defense to the arbitration agreement. For the reasons set forth below, we affirm the decision of the district court.

BACKGROUND

DAI is a Florida corporation with its principal place of business in Fort Lauderdale, Florida and an office in Milford, Connecticut. In June 1995 Hamilton entered into a franchise agreement (the "Agreement") with DAI, permitting him to operate a Subway shop in Voorhees, New Jersey. Several provisions of the Agreement are relevant to the issues on appeal. Paragraph 10(c) of the Agreement contains an arbitration clause (and an arbitral forum selection clause), which states:

> Any dispute or claim arising out of or relating to this Agreement not settled by the parties . . . in accordance with the terms of this Agreement is to be submitted directly to arbitration, shall be settled in accordance with the Expedited Procedures of the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held at Bridgeport, Connecticut. Judgment upon an award rendered by the Arbitrator may be entered in any court having jurisdiction. The commencement of . . . arbitration proceedings by an aggrieved party to settle any such dispute or claim is a condition precedent to the commencement of legal action by either party, except as specifically provided in this Agreement.

Paragraph 10(b) of the Agreement further provides that the Federal Arbitration Act ("FAA" or "the Act"), 9 U.S.C. §§ 1-16, applies to all claims arising out of, among other things, "applicable state franchise disclosure or franchise relationship statutes." The Agreement, under Paragraph 10(d), also provides, in pertinent part, that "the total of all permissible claims arising under or relating to this Agreement, including the breach thereof, for damages made by either party against the other shall not exceed $50,000" ("$50,000 limit" or "liability cap"). Finally, Paragraph 13

contains a choice-of-law provision, which provides that the "Agreement shall be governed by and construed in accordance with the laws of the State of Florida without reference to the body of laws governing conflicts of law."

On December 26, 1996 DAI filed a demand for arbitration with the American Arbitration Association (AAA) to resolve a dispute with Hamilton who claimed he had been fraudulently induced to enter into the Agreement. DAI requested a declaratory judgment that it had not committed fraud and that "any failure of [Hamilton's] business and loss of money was entirely [Hamilton's] responsibility."

On January 22, 1997 Hamilton filed a lawsuit against DAI in the Superior Court of New Jersey (the "New Jersey suit"), alleging that DAI fraudulently induced him to enter into the Agreement and violated the New Jersey Franchise Practices Act. *See* N.J. Stat. Ann. §§ 56:10-1 to 56:10-15 (West 1989). In addition to DAI, Hamilton named as defendants Michael Stocklin and William McClain, both of whom were development agents for DAI. At the time Hamilton filed his complaint, Stocklin was a New Jersey resident. Hamilton alleged that Stocklin and McClain, in conjunction with DAI, made various fraudulent misrepresentations to him concerning the past sales and other aspects of the store he eventually operated. Hamilton sought over $1 million in actual and punitive damages in addition to attorney's fees.

On March 14, 1997 DAI filed this petition to compel arbitration of the dispute between it and Hamilton and moved to enjoin Hamilton from prosecuting the New Jersey suit. Initially, on May 21, 1997 the district court rejected all of Hamilton's defenses to DAI's petition to compel arbitration. Nonetheless, the court denied, without prejudice to renewal, DAI's petition and motion because it believed Hamilton had alleged that he was fraudulently induced into agreeing to the

arbitration clause of the Agreement. The district court held that this issue had to be resolved by the state court before a stay would issue. On September 18, 1997, however, after receiving supplemental briefing on the issue, the district court determined that Hamilton's "allegations of fraud in the inducement relate[d] to the franchise agreement as a whole, rather than the arbitration clause." The court therefore concluded that Hamilton's fraud in the inducement claim should be resolved by the arbitrator and it granted DAI's petition to compel arbitration and enjoined Hamilton from prosecuting the New Jersey suit.

This appeal followed.

DISCUSSION

On appeal, Hamilton contends that the district court erred in compelling arbitration because it had no subject matter jurisdiction. According to Hamilton, DAI did not satisfy the requirement for diversity jurisdiction because the Agreement limited damages to $50,000, and Section 4 of the Act does not provide a "federal statutory cause of action permitting the federal courts to determine the arbitrability of pending, non-removable, state damage claims." Hamilton also contends that the district court erred by failing to apply New Jersey law to determine the enforceability of the arbitral forum selection clause and to resolve his unconscionability defense to the arbitration agreement. Hamilton argues that the Agreement's choice of law provision that designated Florida law as the law governing the parties' relationship is void because it conflicts with New Jersey law. These arguments lack merit.

When reviewing a district court's decision regarding subject matter jurisdiction, we review factual findings for clear error and legal conclusions *de novo*. *See Conntech Dev. Co. v. University of Connecticut Educ. Properties*, 102 F.3d 677,

681 (2d Cir. 1996). We review a district court's decision to compel arbitration *de novo*. *See Doctor's Assocs.* v. *Distajo*, 66 F.3d 438, 444 (2d Cir. 1995), *cert. denied*, 517 U.S. 1120 (1996) (*Distajo I*).

I. *Subject Matter Jurisdiction*

A. *Amount-in-Controversy Requirement*

Hamilton argues that the district court erred in deciding that diversity jurisdiction existed. According to Hamilton, Paragraph 10(d) of the Agreement limits damages to $50,000, which is less than the $75,000 amount-in-controversy requirement. *See* 28 U.S.C. § 1332. The district court rejected this argument, observing that Hamilton, in the New Jersey suit, "seeks over $1,000,000 in damages . . . well over the $75,000 [jurisdictional] minimum. [Hamilton] has ignored the cap on damages set forth in the franchise agreement, and as a result, DAI is forced to defend a claim for over $1,000,000." The district court concluded that "[t]he damages sought in the state action . . . is the amount in controversy." We agree.

DAI's petition to compel arbitration states that the amount in controversy exceeds $75,000. "[T]he sum claimed by the plaintiff [DAI] controls if the claim is apparently made in good faith. It must appear *to a legal certainty* that the claim is really for less than the jurisdictional amount to justify a dismissal." *A.F.A. Tours* v. *Whitchurch*, 937 F.2d 82, 87 (2d Cir. 1991) (citation and internal quotation marks omitted). In the context of a petition to compel arbitration, we have advised district courts to "look through to the possible award resulting from the desired arbitration, since the petition to compel arbitration is only the initial step in a litigation which seeks as its goal a judgment affirming the award." *Davenport* v. *Proctor & Gamble Mfg. Co.*, 241 F.2d 511, 514 (2d Cir.

1957); *see also Jumara* v. *State Farm Ins. Co.*, 55 F.3d 873, 877 (3d Cir. 1995) ("[T]he amount in controversy in a petition to compel arbitration . . . is determined by the underlying cause of action that would be arbitrated."); *Webb* v. *Investacorp*, 89 F.3d 252, 257 n.1 (5th Cir. 1996) (per curiam) (noting that the amount in controversy is the difference "between winning and losing the underlying arbitration").

Here, the underlying dispute to be arbitrated is Hamilton's claim that he was fraudulently induced to enter into the Agreement with DAI, that DAI violated the New Jersey Franchise Practices Act, and that DAI bears the financial responsibility for his losses. In the New Jersey suit, Hamilton, apparently contesting the validity of the liability cap, seeks in excess of $1 million in damages, well over the $75,000 jurisdictional minimum. Should the parties proceed to arbitration and DAI prevail, DAI would have defeated a claim in excess of $1 million in damages. Therefore, the district court properly concluded that notwithstanding the liability cap in the contract, the amount-in-controversy requirement had been met as it could not be said to a "legal certainty" that the award resulting from Hamilton's claims would not exceed the $75,000 jurisdictional minimum.

We dispose of Hamilton's remaining argument that the district court improperly declined to determine the validity of the liability cap before holding that the jurisdictional minimum of $75,000 was satisfied. As the district court properly concluded, Hamilton's request in the New Jersey suit for recovery in excess of the liability cap was the decisive basis for determining the amount in controversy.

B. *Diversity of Citizenship*

Hamilton claims that the district court erred in compelling arbitration "because 9 U.S.C. § 4 does not provide a federal statutory cause of action to determine the arbitrability of damage claims pending in a previously filed, non-removable[ ] state case." In other words, Hamilton argues that there cannot be diversity jurisdiction in DAI's federal lawsuit because of the lack of complete diversity of citizenship among the parties in the New Jersey suit. The district court rejected Hamilton's argument, concluding that diversity jurisdiction is determined by reference to the parties to the petition to compel arbitration, not the parties to the New Jersey suit. We agree.

Section 4 of the Act provides that "[a] party aggrieved by the alleged failure . . . of another to arbitrate . . . may petition any United States district court which . . . would have jurisdiction . . . of the subject matter of a suit *arising out of the controversy between the parties*." 9 U.S.C. § 4 (emphasis added). In *Distajo I*, we interpreted "controversy between the parties" to mean the dispute between the parties to the petition to compel arbitration. *Distajo I*, 66 F.3d at 445. We reasoned that "[a]s with any federal action, diversity of citizenship is determined by reference to the parties named in the proceedings before the district court, as well as any indispensable parties who must be joined pursuant to Rule 19 of the Federal Rules of Civil Procedure." *Id.* We declined to determine diversity of citizenship by reference to the parties named in a parallel state action because "a party resisting arbitration could defeat federal jurisdiction simply by suing someone from the same state, plus the party seeking to compel arbitration, in a separate state lawsuit." *Id.*

Here it is clear from the pleadings that the parties to this petition, Hamilton, a New Jersey citizen, and DAI, a Florida

corporation, are diverse. Furthermore, Hamilton makes no claim, nor do we perceive any basis for a claim, that either McClain or Stocklin, defendants in the parallel state action, are indispensable parties to the petition to compel arbitration. *See* Fed. R. Civ. P. 19; *Distajo I*, 66 F.3d at 446.

In sum, we are satisfied that the district court had diversity jurisdiction over this action and that Hamilton's jurisdictional challenges are without merit.

II. *Application of New Jersey Law*

Hamilton argues that the district court erred by failing to apply New Jersey law to determine the enforceability of the Agreement's arbitral forum selection clause and to review his unconscionability defense. Hamilton contends that the arbitral forum selection clause is void and unenforceable as against the public policy of New Jersey and that the arbitration clause is unconscionable to the extent that it requires Hamilton to travel to Connecticut to arbitrate and to share the costs of arbitration. Hamilton also argues that the Agreement's choice of law clause designating Florida law as the law governing the parties' relationship is void because it contravenes the public policy behind the New Jersey franchise law. In support of his challenge to the forum selection clause, Hamilton relies on *Kubis & Perszyk Assocs.* v. *Sun Microsystems*, 146 N.J. 176, 680 A.2d 618 (1996), in which the New Jersey Supreme Court held that a forum selection clause in a franchise agreement which designated an out-of-state *judicial* forum was presumptively invalid under the state's franchise protection act. *Kubis*, 146 N.J. at 195, 680 A.2d at 627.

The district court rejected these arguments. It distinguished *Kubis* as dealing with a clause designating a judicial forum, not an arbitral forum. The court then held that to the extent that *Kubis* applied to arbitral forum selection clauses, it was

preempted by the FAA. As expressed in *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984), the Act "foreclose[d] state legislative attempts to undercut the enforceability of arbitration agreements." *Id.* at 16. According to the district court, *Kubis* did not set forth a defense to an arbitration agreement "that exists [at] law or in equity for the revocation of any contract." (quoting *Southland*, 465 U.S. at 16 n.11.) (internal quotation marks omitted). Furthermore, the district court rejected Hamilton's unconscionability defense to arbitration citing our holding in *Doctor's Assocs.* v. *Stuart*, 85 F.3d 975 (2d Cir. 1996), where we rejected an unconscionability argument nearly identical to Hamilton's. *Id.* at 980-81. The district court also concluded that Hamilton was obligated to arbitrate his disputes with DAI regardless of the enforceability of the choice of law provision. On review, we affirm the district court's conclusions.

A. *Standard*

Any analysis of a party's challenge to the enforcement of an arbitration agreement must begin by recognizing the FAA's strong policy in favor of rigorously enforcing arbitration agreements. *See Perry* v. *Thomas*, 482 U.S. 483, 490 (1987). The Supreme Court has observed that " '[t]he preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered.' " *Id.* (quoting *Dean Witter Reynolds* v. *Byrd*, 470 U.S. 213, 221 (1985)) (alteration in original).

This policy favoring arbitration is reflected in the narrow role played by state law in FAA jurisprudence. The Supreme Court has declared that the FAA preempts all state laws that impermissibly burden arbitration agreements. *See Southland*, 465 U.S. at 10-11. In *Southland*, the Supreme Court reversed the California Supreme Court's holding that claims under California's franchise act were not subject to arbitration

under the parties' arbitration agreement. The Supreme Court held that the FAA preempted the California act: "In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Id.* at 10; *see also Mastrobuono* v. *Shearson Lehman Hutton*, 514 U.S. 52, 56 (1995).

Section 2 of the FAA provides that arbitration agreements subject to the FAA "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Supreme Court has explained the significance of this section:

> [T]he text of § 2 provides the touchstone for choosing between state-law principles and the princi ples of federal common law envisioned by the passage of that statute: An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, . . . "save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). Thus state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.

Perry, 482 U.S. at 492 n.9 (citation omitted). In short, the Court has declared that only "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs.* v. *Casarotto*, 517 U.S. 681, 687 (1996). In addition, the Supreme Court has found "nothing in the Act indicating that the broad principle of enforceability [of arbitration agreements] is subject to any additional limitations under state law." *Southland*, 465 U.S. at 11.

In the light of these principles, we examine Hamilton's challenges to the enforceability of the Agreement's arbitral forum selection and arbitration clauses.

B. *Analysis*

1. *Arbitral Forum Selection Clause*

Hamilton contends the district court erroneously failed to apply New Jersey law to determine the enforceability of the Agreement's arbitral forum selection clause. Despite the clear language in *Southland*, Hamilton urges us to rely on *Kubis & Perszyk Assocs.* v. *Sun Microsystems*, 146 N.J. 176, 680 A.2d 618 (1996), to invalidate the Agreement's arbitral forum selection clause. Recognizing that state law may affect the validity and enforceability of arbitration to the extent that the state law applies to "the revocation of *any* contract," 9 U.S.C. § 2 (emphasis added), Hamilton maintains that the rule set forth in *Kubis* applies to all contracts, including the Agreement here.

We disagree. *Kubis* did not establish a "generally applicable" contract defense that applies to "any" contract; it invalidated a franchise agreement's forum selection clause under the New Jersey Franchise Practices Act because it required the franchisee to sue in another jurisdiction. The *Kubis* decision applies to one sort of contract provision (forum selection) in only one type of contract (a franchise agreement). Therefore, to the extent that *Kubis* can be read to invalidate arbitral forum selection clauses in franchise agreements, it is preempted by the FAA. *See Management Recruiters Int'l* v. *Bloor*, 129 F.3d 851, 856 (6th Cir. 1997) (if the Washington Franchise Investment Protection Act "imposed an absolute requirement of in-state arbitration notwithstanding the parties' agreement to arbitrate [elsewhere], its validity would be in serious doubt as a result of

the preemptive effect of the FAA"); *Stirlen* v. *Supercuts*, 51 Cal. App.4th 1519, 1543, 60 Cal. Rptr.2d 138, 153 (Cal. Ct. App. 1997) (recognizing that state statutes conflicting with the pro-arbitration policy of the FAA will be preempted).

2. *Unconscionability*

Hamilton argues that the arbitration clause of the Agreement is unconscionable because of the high costs and prejudice involved in arbitrating. According to Hamilton, he is required to travel to Connecticut to pursue his New Jersey franchise act claims and to share the costs of arbitrating before the AAA. Hamilton estimates that his arbitration fees for arbitrating the claims in his New Jersey suit will total between $28,000 and $32,000. He also argues that the AAA is biased in favor of DAI because it relies on DAI for repeat business.

In *Doctor's Assocs.* v. *Stuart*, 85 F.3d 975 (2d Cir. 1996), we rejected an Illinois franchisee's advancement of the identical arguments made here by Hamilton. We concluded that there was nothing unconscionable about the arbitration clause because it clearly explained both the parties' responsibility for their own costs, which the franchisee was free to investigate before entering into the agreement, and that arbitration would take place in Connecticut. *Id.* at 980-81. The Agreement here is equally clear on both issues. In addition, like Hamilton, the franchisee in *Stuart* failed to present any evidence of the AAA's bias in favor of DAI. Because the Agreement here contains an arbitration clause similar to the one in *Stuart* and because Hamilton does not contest receiving notice of that clause, we are satisfied that the arbitration clause is not unconscionable.

Hamilton, however, argues that the district court failed to consult New Jersey law in deciding whether the arbitration

clause was unconscionable. *See Cassarotto*, 517 U.S. at 687 (State law supporting "generally applicable contract defenses, such as . . . unconscionability, may be applied to invalidate arbitration agreements without contravening § 2."); *Progressive Casualty Ins. Co.* v. *C.A. Reaseguradora Nacional De Venezuela*, 991 F.2d 42, 46 (2d Cir. 1993) (Section 2 of the Act "preserves general principles of state contract law as rules of decision on whether the parties have entered into an agreement to arbitrate." (internal quotation marks and citation omitted)). According to Hamilton, the district court instead relied exclusively on *Stuart*, which was not grounded in New Jersey law. *See Stuart*, 85 F.3d at 980 ("The purpose of the unconscionability doctrine is to prevent unfair surprise and oppression." (citations and internal quotation marks omitted)).

Without reaching the merits of Hamilton's contention, we conclude that he has waived this argument. He failed to bring New Jersey law on unconscionability to the attention of the district court or to argue that section 2 of the Act preserved general principles of state law as rules of decision. Even on appeal, Hamilton cites no New Jersey law undermining the conclusion reached in *Stuart*, nor does he make any argument that New Jersey's standard regarding unconscionability is in any material respect different from the law applied in *Stuart*.

Hamilton's final argument is that the Agreement's choice of law provision designating Florida law as the law governing the parties' relationship is void because it conflicts with New Jersey franchise law. We need not decide this question as we have already concluded that none of Hamilton's arguments based on New Jersey law has merit and no question of Florida law is presented on appeal.

In sum, we affirm the district court's rejection of Hamilton's unconscionability and choice of law arguments.

CONCLUSION

Diversity jurisdiction exists over this action. We affirm the district court's order compelling arbitration and enjoining Hamilton from prosecuting his New Jersey suit.